

No. 15,334

IN THE
United States Court of Appeals
For the Ninth Circuit

LUCKY LAGER BREWING COMPANY,
a corporation,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Review of The Tax Court of the United States.

PETITIONER'S OPENING BRIEF.

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PETITIONER'S OPENING BRIEF.

STATEMENT AS TO JURISDICTION.

This case was instituted by a petition filed in the Tax Court within ninety days of the date on which the deficiency letter was mailed (R. 3, 5). Decision of the Tax Court was entered on July 23, 1956, finding a deficiency in income and excess profits tax for the calendar year 1950 in the amount of \$102,343.94. On September 27, 1956, petitioner filed a petition for review by this Court and served notice thereof on the Commissioner of Internal Revenue. (R. 4, 49, 50-54.) The jurisdiction of this Court is founded on Sections 1141 and 1142 of the Internal Revenue Code of 1939 and Sections 7482 and 7483 of the Internal Revenue Code of 1954.

STATEMENT OF THE CASE.

The facts stipulated or found by the Tax Court may be summarized as follows:

Petitioner is a California corporation which brews and sells beer (R. 35). Its principal place of business is in San Francisco (R. 26), and it filed its returns for all years involved with the Collector of Internal Revenue for the Northern District of California (R. 35). It keeps its books and files its tax returns on the calendar year basis (R. 35). Its present name was adopted January 1, 1949, theretofore having been General Brewing Corporation (R. 35).

In computing its liability for the so-called excess profits tax imposed by Congress in 1950, petitioner was taxable on the excess of its 1950 income over its "credit". Its credit was based on its average net income for the three best years of its base period (1946-1949, inclusive), unless by reason of its growth during that period petitioner was entitled to compute its credit upon the basis of its best year in the latter half of the base period, i.e., the better of 1948 or 1949. Whether or not petitioner was a growth corporation entitled to compute its credit solely on the basis of its 1949 earnings depends entirely on whether its "gross receipts" for 1948 and 1949 were half again as great as (that is, 150% of) its "gross receipts" for 1946 and 1947. It had the required rate of growth only if the beer excise taxes which it collected and paid to the federal and state governments are not part of its "gross receipts". (R. 43; 36.)

The term "gross receipts" is defined by Section 435(e)(5) in considerable detail. Otherwise, the term

“gross receipts” used in the governing code section is not one customarily used in accounting practice, the terms ordinarily used being “gross sales” and “net sales” (R. 42; 94). Likewise, the term “gross receipts” was not used on the federal income tax returns for the base period to designate gross returns from sale of property in inventory, the terms actually used being “gross sales” and “gross profit from sales” (R. 31, 33).

During the base period, under the provisions of the federal beer excise tax statute, petitioner was required to prepay the federal tax at the rate of \$8.00 a barrel, prior to the occurrence of the taxable act of selling beer. The state tax was payable by returns after sale. (R. 38.) In view of the period of credit indicated by the ratio of taxpayer’s receivables to total annual sales, it does not appear whether taxpayer paid the state tax just before or just after receiving its customers’ payments (Exhibit I to the Stipulation of Facts.)

In billing its customers petitioner ordinarily did not state the federal and state beer excise taxes separately from the unit price. Invoices covering shipments to Hawaii and other United States territories stated that the federal tax was paid and the shipment was exempt from state tax. Invoices covering shipments to United States possessions (e.g., Samoa) stated that the shipment was tax-free. (R. 37.)

Petitioner regularly published price schedules. Those for California did not state beer excise taxes separately. Those for Nevada stated that the Nevada state excise tax was not included, and after February 1, 1948 they specif-

ically deducted the California beer excise tax. The price schedules for exports showed a deduction of both federal and state taxes in arriving at the price. (R. 37-38.)

Petitioner's published annual reports and its income tax returns for 1946 through 1949 included beer excise taxes collected and paid in the figures shown for gross sales, and deducted them in arriving at net sales by including them without separate identification in cost of goods sold (R. 35-36, 38). The net income reported would not have been changed whether petitioner excluded the beer excise taxes from gross sales (as is customary for many excise taxes), deducted them from gross sales by including them in cost of goods sold, or deducted them as a separate tax deduction.

Petitioner's practice was not followed by a single one of nine other breweries chosen at random from S.E.C. files for comparison, although all of them included beer excise taxes in the amount reported as gross sales. One of the other breweries deducted the beer excises as a separate deduction from gross sales to arrive at gross profit. Seven of them deducted beer excises as a separate deduction, along with cost of goods sold, in arriving at net sales. The ninth one did, like petitioner, include beer excises in cost of goods sold, but dropped a footnote stating that the item included beer excises in a specified amount. (R. 41; 83-84, 87-92.)

There is no uniform practice with regard to the inclusion or exclusion of excise taxes in gross sales as reported for tax and corporate purposes. In some industries, excise taxes are usually included in reported gross sales. In others they are usually excluded. Thus petroleum com-

panies exclude federal and state gasoline taxes from gross sales. Retail stores exclude state and city retail sales taxes from their reported gross sales, as well as luxury taxes such as those on furs. The federal excise tax on phonographs and television sets is also customarily excluded from gross sales. The inclusion or exclusion, as the case may be, does not depend on whether the taxpayer sells to a distributor or directly to the consumer. The effect of exclusion of these taxes from reports of gross sales is to omit them from both income and deductions. (R. 40-41; 80-83; 85-87; 93.) They therefore simply do not appear in the taxpayers' corporate reports or income tax returns.

Prior to a change in the regulations made effective on March 1, 1950, petitioner along with other breweries paid the federal beer excise tax by stamps which had to be purchased in advance and were surrendered when the beer was canned or bottled for sale. After March 1, 1950, the stamps still had to be purchased but were affixed only when the beer was removed from the bonded premises for sale or consumption. There was no change in the statute to account for this change in procedure. (R. 8-39; 29-30.) The state beer excise tax was paid monthly after the sales were made (R. 38; 28).

Beer excise taxes were not imposed as a percentage of sales or gross receipts but were a flat tax per unit of beer. Their rate did not increase during the base period. (R. 46.)

The Tax Court held that petitioner's collections of beer excise taxes were part of its "gross receipts" within the meaning of the statute, and therefore its growth was

not sufficient in terms of its increase in gross receipts to qualify it for the alternative credit allowed to growth corporations (R. 42, 48). Consequently it sustained respondent's determination of a deficiency of \$102,343.94 in petitioner's tax for 1950 (R. 49).

SPECIFICATION OF ERRORS.

1. The Tax Court erred in holding that petitioner's collections of beer excise taxes were part of its "gross receipts" for purposes of I.R.C. Section 434(e), a provision designed to provide a fairer measure of excess profits for taxpayers that had experienced a specified rate of growth of output in the base period.

2. The Tax Court erred in denying petitioner classification as a growth corporation entitled to use the alternative credit for computing its excess profits tax.

STATUTES INVOLVED.

The statutes and regulations involved are printed in Appendix A, *infra*.

SUMMARY OF ARGUMENT.

The issue. The dispute in this case is about the amount of petitioner's excess profits credit. The credit serves as an exemption, so that only so much of petitioner's net income for 1950 as exceeds its credit is subject to excess profits tax. The credit normally allowed was an amount

equal to 85% of the average base period net income, that net income being the average of the net income for the best three of the four years 1946-1949, inclusive. However, in recognition of the fact that some corporations were in the process of permanently increasing their productive capacity during that base period, so that an average which took into account the earlier years before growth was attained would be an unfair measure of excess profits, special formulae were provided for growth corporations. These special formulae used only the income of the last two years of the base period in determining the credit, and the formula petitioner will use if qualified to use any special formula is its net income for 1949. Thus, if petitioner is correct, it will be entitled to earn in 1950 85% of what it earned in 1949 without being taxed on "excess profits". But if petitioner is wrong, its credit will be depressed by having to take into account lower years of earnings earlier in the base period. Petitioner did grow during the base period; the question is whether it grew the required 50% when its growth is measured in terms of its "gross receipts", and this in turn depends on whether the beer excise taxes it collected and paid to the state and federal governments are part of its "gross receipts". If they are not, its gross receipts did grow by the 50% required to qualify. If they are, petitioner's growth is insufficient to qualify and it must pay an "excess profits tax" even though it does not earn as much as it did in a year before that tax was enacted.

I. In the Excess Profits Tax Act the term "gross receipts" is defined at some length so that it will be an index of the growth in physical volume of production of

a taxpayer. The definition generally includes all amounts received from the sale or exchange of taxpayer's stock in trade, property properly includible in taxpayer's inventory and property primarily held by the taxpayer for sale to its customers and, in addition, gross income derived from carrying on its trade or business.

It is the position of petitioner that there is no room in this definition for amounts which merely reimburse it for federal taxes which it has paid and which were levied upon the manufacture and sale or delivery for consumption of its product and some state taxes which were levied upon such sales. The precise terms of the statute would exclude such taxes by failing to include them and a fair interpretation of the statute should require their exclusion from the receipts of the taxpayer, even though those receipts were not segregated on the books of the taxpayer.

II. While it appears to us that the normal intendment of the statutory language supports petitioner's position, only the interpretation petitioner urges will give the statute equal and uniform effect in measuring growth.

For reasons too complex to be briefly summarized but which are developed in the text of the Argument, the interpretation adopted by the Tax Court results in there being varying rates of growth required for different industries, and even for different members of the same industry. Members of an industry subject to an excise tax which is a flat figure per unit must grow more than members of an industry subject to an excise tax which is a percentage of sales price, in order to qualify as a growth corporation under the interpretation adopted below. Moreover, there can even be varying rates of growth required

for members of the same industry, under the Tax Court's view, dependent on the amount of export sales and on the states in which taxable sales are made.

The Tax Court's interpretation also requires that the qualification of a growth corporation be determined on the basis of figures and facts not required to be shown in income tax returns for the periods involved. Many of the excise taxes paid by taxpayers for which they are reimbursed by their customers are not shown or reflected in their income tax returns in any manner or form. Yet the Tax Court held that all excise taxes are part of the "gross receipts" by which growth during the base period should be measured. One would not suppose that Congress meant to require that the amount of the 1950 additional income tax known as the excess profits tax be determined on the basis of figures not found in income tax returns, but, if the decision below is correct, Congress did this improbable act.

The critical term "gross receipts" has no accepted meaning in accounting or business usage, or in income tax experience. It has, however, been used as the measure of many state and local sales taxes, where it has more often than not been interpreted contrary to the interpretation accepted below. *Standard Oil Co. v. State Tax Commissioner*, (1941) 71 N.D. 146, 299 N.W. 447, excluding excise tax reimbursements from "gross receipts", exemplifies the majority view which the Tax Court refused to follow.

Yet the available extrinsic evidence indicates that, contrary to the Tax Court, Congress agrees with the majority view. When the Supreme Court in *Lash's Products Co. v. United States*, (1929) 278 U.S. 175, involving a distinguish-

able statutory phrase, lined up with the minority view, Congress overruled it in Section 615 of the Revenue Act of 1932, a provision continued in the 1939 Code as Section 3441(a) and in the 1954 Code as Section 4216(a). Thus when Congress explicitly focussed on this precise problem, it provided that for tax purposes a taxpayer should not be accountable for collections of commodity excise taxes.

In view of the facts that any other view in the instant case will promote lack of uniform application and administrative complexity and will adopt a test not germane to the purpose of the test, the view Congress adopted in 1932 should be accepted here.

ARGUMENT.

INTRODUCTORY—THE ISSUE.

The tax involved is the excess profits tax imposed as the result of the outbreak of the Korean hostilities, which began about the middle of 1950. The statute involved (Public Law 909, 81st Congress) was entitled "Excess Profits Tax Act of 1950" although its enactment was not completed until January 3, 1951. It was applicable to corporate income for 1950, which is the year before the court.

The Senate Finance Committee stated the justification for the statute in the following words (S.Rep. 2679, 81st Cong., 2d Sess., p. 2; 1951-1 Cum. Bul. 241):

"One of the main advantages of an excess profits tax in periods of large military expansion is that it selects for additional tax those corporations whose profits are higher than they probably would have

been in the absence of hostilities and a large military budget.”

The House Committee on Ways and Means said the same thing in these words:¹

“Your committee conceives of this tax as primarily a tax on increased profits due to the outbreak of hostilities and to large military expenditures.”

Petitioner is seeking to have its excess profits for 1950 determined by comparison with its profits for 1949, the last year in which any increase in profits could not have been attributable to the Korean outbreak. The position of respondent and the Tax Court requires that petitioner's profits for 1950 be compared not with those for 1949 alone, but with those for 1948 and 1947, as well, in which years they were lower. Petitioner's profits showed a continual growth through the base period,² and by 1949 had increased to \$3,862,084.81 (R. 17). In 1950 they were \$4,223,116.33 (R. 13), reflecting an increase from the last year in which they could not have been influenced by the Korean outbreak in the amount of \$361,031.52. Since Congress meant to tax profits which were “higher than they probably would have been in the absence of hostilities and a large military budget,” the declared purpose will be served if the 1950 profits are compared with those of 1949, as petitioner contends.

¹H.Rep. No. 3142, 81st Cong., 2d Sess., p. 3; 1951-1 Cum. Bul. 188.

²They were \$2,013,534.81 in 1946, \$2,077,960.52 in 1947, \$2,345,046.32 in 1948, \$3,862,084.81 in 1949 (R. 17), and \$4,223,116.33 in 1950 (R. 13).

Congress also recognized that 1949 and other years preceding 1950 were exceptionally good years for many corporations, and Congress felt that without the boost to the economy supplied by material demands of the Korean affair profits might have begun to decline by 1950. Therefore, the Excess Profits Tax Act of 1950 provided that in comparing 1950 earnings to earnings of a prior year or years for the purpose of determining what part of the 1950 earnings was "excess profits", i.e., profits attributable to the Korean affair, only 85% of the prior years' earnings could be considered.³

By 1949, petitioner's net income had climbed to \$3,862,084.81 from \$2,013,534.81 in 1946, so petitioner contends its credit should be 85% of the 1949 figure. Respondent, however, contends that petitioner's war profits credit should be determined, not by its earnings in the last single year not affected by the Korean hostilities, but by the last *three* such years. As petitioner's earnings increased each year from 1946 to 1949, inclusive, averaging its 1949 earnings with its earnings for 1948 and 1947 reduces the earnings figure from \$3,862,084.81 to \$2,761,697.22 (R. 17), which in turn is reduced to 85%

³Sec. 435(a), I.R.C. of 1939, as enacted in 1951. It was amended later in 1951 to reduce the percentage to be recognized for future years to 83%. This limitation was explained by its progenitor, the House Ways and Means Committee, as follows (H.Rep. No. 3142, 81st Cong., 2d Sess., p. 2; 1951-1 Cum. Bul. 181) :

"By limiting the credit based upon income to 85 per cent of the base period earnings, the bill will reach some profits which are being sustained at the relatively high levels of the base period by the increased tempo of the defense economy."

The explanation is enlarged upon, substantially as stated in the text, in the same report at page 5, 1951-1 Cum. Bul. at p. 190. See Appendix B, *infra*.

for credit purposes. In terms of figures, this presents the issue raised by the case.

Respondent's effort to reduce petitioner's credit by depriving it of the full benefit of its growth during the base period is based fundamentally on the fact that Congress patterned the Korean excess profits tax after the World War II excess profits tax in ordinarily using an average of several years in a base period as the measure of the credit. Thus under Section 435, the excess profits credit for 1950 is ordinarily 85% of the average base period net income, which is the average of the net income of the taxpayer's three best years in the base period 1946-1949. Respondent's position is thus that petitioner must use the credit designed for the ordinary case.

Congress provided a special rule for growth corporations, which petitioner claims to be. If petitioner is a growth corporation as defined by the statute, then it is entitled to have its excess profits for 1950 determined by comparison with its net income for the single year 1949, which petitioner contends Congress intended. Respondent denies that petitioner is a growth corporation and if respondent is correct, as the Tax Court held, petitioner's credit must be depressed by consideration of the earlier, lower years of earnings.

Although the credit and the earnings on which it is based are both expressed in terms of net income, the tests for qualifying as a growth corporation are not. Petitioner's net income for the last two years of the base period was more than half again as large as for the first two years, the exact ratio being 151.7 to 100. This is not controlling, however, because Congress wrote Sec-

tion 435(e) so as to require that growth be measured in terms of "payroll" (where the required ratio is 130 to 100), or "gross receipts" (where the required ratio is 150 to 100). Thus only if petitioner's payroll for the last half of the base period 1946-1949 is larger than that for the first half in the ratio of 130 to 100, or if petitioner's gross receipts for the last half are larger than those for the first half in the ratio of 150 to 100, does petitioner qualify as a growth corporation. Petitioner does not meet the payroll test of growth. Petitioner contends that it does meet the gross receipts test of growth because its gross receipts for the last half of the base period exceed those for the first half by more than the required ratio of 150 to 100.

Respondent has, however, included petitioner's collections of reimbursement for federal and state beer excise taxes in petitioner's gross receipts and thereby reduced the ratio to 140.69 to 100. The Tax Court has sustained respondent, and the sole issue is whether those tax reimbursements must be included in petitioner's gross receipts.

The term "gross receipts" is not one of heretofore established meaning in income tax law, nor is it one customarily used by accountants in defining or classifying accounts (R. 42; 94). Therefore Congress had to define it, which definition is in Section 435(e)(5) [Appendix A, *infra*].

I. THE DEFINITION IN SECTION 435(e)(5) OF THE INTERNAL REVENUE CODE OF 1939 EXCLUDES BEER EXCISE TAXES FROM "GROSS RECEIPTS".

Section 435(e)(5)(A) defines "gross receipts" for the purpose of this index of growth by a corporation as the "total amount received . . . *from* the sale, exchange, or other disposition of *stock in trade* . . . or other *property* of a kind which would properly be included in the inventory of the taxpayer . . . or *property* held by the taxpayer primarily for sale to customers in the ordinary course of trade or business." (Emphasis added.) The language used here does not fairly lend itself to an interpretation against the taxpayer that this definition should include among amounts received for stock in trade, or for property, collections which merely reimburse the taxpayer for excise taxes which had been paid and which were levied upon the sale, or upon the sale and delivery for consumption, of such property.

In other words, that amount of petitioner's collections which merely restored the payments which it had made in paying a tax to the federal government and the various state governments in which the sales occurred did not constitute moneys which it had received for stock in trade or for property.

It is contended by the petitioner that the express itemization of the phrases "stock in trade" and "property" limits the phrase "the total amount received" to those receipts which are referable to the physical property and does not include those collections which merely result from an exaction imposed upon the sale of the product of this

business, a type of exaction imposed in varying amounts on some other businesses and not at all on most businesses.

The petitioner submits that the opinion of the Tax Court begs the question of whether this money was received by the taxpayer for its stock in trade, or for property properly includible in its inventory, or for property held primarily for sale to its customers. Such treatment discards or ignores all of subdivision (A) of Section 435(e)(5) except the phrase "the total amount received." The Tax Court's interpretation of the statute also would eliminate all need for subdivision (B) of Section 435(e)(5), which includes the "gross income" of the taxpayer arising from the conduct of its business in its "gross receipts" (with the exception of certain exclusions therefrom not referable to the physical volume of production). Such a conclusion that part of the statute establishing the index of growth by a corporation is redundant also leaves all four of these last mentioned exclusions without anything from which to be excluded.

The interpretation contended for by respondent enlarges the statutory definition. The respondent's contention also results in an index which is not uniform for taxpayers who have different taxes, for taxpayers who have taxes as against taxpayers who do not have taxes levied upon the sale of their product, and which is ununiform because the taxes are levied in varying amounts depending upon the state in which the sales are made and because there are no such taxes upon export sales.

(A) There Is No Reason or Room in the Statutory Definition of "Gross Receipts" for Excise Tax Reimbursements.

A simple reading of the statute in the case at bar would seem to petitioner to make the answer to the issue involved obvious. "Gross receipts" are defined thereby to include the total amount received from the following items:

(1) The stock in trade of the taxpayer.

(2) Other property of the kind which would properly be includible in the inventory of the taxpayer if on hand at the close of the taxable year.

(3) Property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business.

Nowhere therein is included amounts reimbursing the taxpayer for beer excise taxes advanced by the petitioner upon the sale of its product. Where a statute specifically enumerates certain items, it by implication excludes all others from that classification:

Arthur v. Cumming, (1876) 1 Otto (91 U.S.) 362;

United States v. Arredondo, (1832) 6 Pet. (31 U.S.) 689, 691;

Mintz v. Baldwin, (1933) 289 U.S. 346.

Yet despite this obvious statutory itemization, and the above canon of construction, the Tax Court made the following statement:

"Petitioner is in effect asking that we reject a simple and direct application of the term 'total amount received' as including everything received by the corporation in its own right, and employ instead a meaning which will give effect to the statutory purpose. We need not determine whether such an

approach is permissible. Even if it were, it seems to us that the object of the statute as shown by its legislative history will best be served by including all items actually received . . .” (R. 47.)

We are not asking the court to “reject a simple and direct application of the statute” but to read its entire terms and the enumerations contained in it.

We are also requesting the court to give particular heed in its discussion of the legislative history of the statute to the many statements of the Congress such as that appearing in Senate Report No. 2679 (81st Congress, Second Session, p. 27) and House Report No. 3142 (81st Congress, Second Session, p. 24) on the Excess Profits Tax Act of 1950:

“ . . . The use of the alternative gross receipts test is justified by the fact that a corporation *may increase its physical volume of production materially* by introducing additional equipment and new operating procedures which do not involve a corresponding increase in its labor force. The percentages used in the payroll and gross receipts test are sufficiently large so that only those taxpayers will be able to qualify whose businesses have grown substantially more rapidly than the average during the base period years.” (Emphasis added; see Appendix B, *infra*.)

From such statements of the legislators it is quite apparent that Congress intended to measure the growth of a taxpayer by the increase in its “physical volume of production” and thus intended to include in “gross receipts” only those beneficial receipts of the taxpayer which reflected sales of its products. We submit that there is nothing in the statutory definition which authorizes or

permits the addition to these amounts of taxes upon some of these sales and in varying amounts upon other of these sales which had to be prepaid and thereafter collected along with the proceeds of the sale.

The refusal of the Tax Court to recognize that the reimbursements for the excise taxes do not measure but distort the increased “physical volume of production” of petitioner disregards the intent of Congress and violates the rule of construction “*expressio unius exclusio alterius.*”

The Tax Court has by implication admitted that beer excise taxes are neither the inventory of the taxpayer nor property held by the taxpayer primarily for sale to its customers, when it directed the issue of the case at bar at the following phrase of Section 435(e)(5) of the 1939 Internal Revenue Code:

“The total amount received or accrued . . . from the sale . . . of stock in trade of the taxpayer.” (R. 44.)

However, the court has included the reimbursements for such taxes in the amount received by the taxpayer for its stock in trade. With this latter conclusion we cannot agree.

The Tax Court in its opinion seems to think that the use of the word “total” in the phrase “total amounts received” enlarges the definition as against the phrase if it had read “the amounts received for.” We submit that the use of the word “total” by Congress meant that the amounts received for the three items stock in trade, property properly includible in inventory, and property held primarily for sale to customers should be

totalled. The word "total" is redundant unless there is more than one amount.

To give the word "total" any other significance would be to say that the "total amount received for beer" was something other than "the amount received for beer."

The petitioner is in the business of brewing and selling beer, not of selling taxes or collecting them for the federal government. Beer is thus its stock in trade, not taxes.

The beer excise tax aspect of the situation arises principally by virtue of Section 3150 of the 1939 Internal Revenue Code. Subsection (a) levies a tax on all the beer "manufactured and sold, or removed for consumption or sale" and subsection (b) requires that "said tax shall be paid by the owner, agent, or superintendent of the brewery." Sections 3153 and 3154 provide for refunds and credits of the beer excise tax for unsalable products, loss, breakage, leakage and transfers in bond. Thus, this tax is not a manufacturer's tax but a sales tax and cannot possibly be classified as petitioner's stock in trade even from this point of view. This argument is here only mentioned because such technical distinctions upon the incidents of liability for the beer tax have no place in determining the purpose and object of the excess profits tax. We are in complete accord with the following statement of the Tax Court in this respect:

"On this approach (the object of the statute) to the meaning of the Excess Profits Tax provision, it is of no consequence whether the beer taxes are manufacturers' taxes or sales taxes." (R. 47.)

However, to hold as the Tax Court did (R. 47) that the reimbursements to petitioner for the tax paid upon

the "manufacture and sale" of its beer "were included in the amount received for its stock in trade" ignores these heretofore mentioned facts, disregards the wording of Section 435(e)(5) of the Internal Revenue Code of 1939 and is contrary to the plain accepted meaning of "stock in trade."

"Stock in trade" has been defined as follows:

"... stock in trade . . . is a stock of merchandise as that term is ordinarily used among business men. This term includes the goods or chattels which a merchant holds for sale (*Shasta Lumber Company v. McCoy*, 85 Cal. App. 468 [259 Pac. 965]; *Charles J. Off & Co. v. Morehead*, 255 Ill. 40 [85 N.E. 264, 126 Am. St. Rep. 189, 14 Ann. Cas. 434, 20 L.R.A. (N.S.) 167]; *Swift & Co. v. Tempelos*, 178 N.C. 487 [101 S.E. 8, 7 A.L.R. 1581]). It is 'the visible and tangible property with which the trade or business of the owner is carried on, and to which it relates.' (*New York Biscuit Co. v. Cambridge*, 161 Mass. 326 [37 N.E. 438])."

Story v. Christin (1939), 14 C.2d 592, 595-596, 95 P.2d 925.

"Merchandise or goods kept for sale or traffic." (*Black's Law Dictionary*, 3rd Edition 1933, p. 1662.)

"The goods kept for sale by a shopkeeper." (*Webster's New International Dictionary*, 2nd Edition, 1949, p. 2481.)

Where in any of these definitions is there room for beer excise taxes? Such taxes are certainly not "goods," "chattels" or "merchandise" held by petitioner for sale to its customers. The contrary conclusion that the beer tax is the petitioner's stock in trade would be at complete

variance "as that term is ordinarily used among business men."

Section 435(e)(5) is, of course, defining the term "gross receipts," and the portion of this definition with which we are concerned requires that the amounts includible therein be "*received* from the sale . . . of stock in trade" (emphasis added). Petitioner is at a loss to understand the classification of the beer excise taxes as such "receipts". These reimbursements were paid to the petitioner only after it had advanced the amount of the taxes to the governments involved. In what manner can the petitioner be said to have "received" anything for its stock in trade until the payment of the sales price totals more than it has paid out in taxes? Until this point is reached the petitioner has only been reimbursed for the excise taxes advanced.

Does the bank depositor have any "receipts" when he withdraws his account until he receives interest thereon? Is the repayment of the principal of a loan "receipts" to the creditor? Obviously the answer in each situation is no. The depositor and the creditor are merely being reimbursed for the amount of the funds advanced to the bank and the debtor.

Why, then, should the reimbursement of beer excise taxes paid in advance by the petitioner be classified as "receipts"? Can it be said that the taxpayer who pays an \$8.00 excise tax and who gets only \$8.00 back after delivering a barrel of beer, has done anything more than give the barrel of beer away for nothing? Can it be argued that the taxpayer has received anything for its beer in such an example?

Prior to March 1, 1950, the tax was paid before the sale or delivery (during this Excess Profits Tax Act's base period), and Section 3154 of the 1939 Internal Revenue Code permitted the Commissioner to refund to a brewer taxes paid on beer which had become unsalable on the brewer's premises. In this event, when the taxpayer had been refunded the \$8.00 per barrel which it had paid and the beer had been destroyed as required by Section 3154, could it be said that the taxpayer had "received" \$8.00 a barrel from the destruction of its beer? Surely not, we submit.

Consequently, the Tax Court's holding that reimbursements for beer excise taxes are part of the "gross receipts" of the petitioner ignores the statutory definition of that term, disregards the express itemization of the items includible therein, negates the intent of Congress that the term should measure the growth in "physical volume of production" and overlooks the fact that the sums includible therein must be "receipts" of the taxpayer.

(B) The Tax Court's Interpretation Renders A Large Portion of the Excess Profits Tax Definition of Gross Receipts Meaningless Surplusage.

The Tax Court made a still further unjustified construction of Section 435(e)(5)(A) when it made the following statement:

"Petitioner is in effect asking that we reject a simple and direct application of the term 'total amount received' *as including everything received by the corporation* in its own right, and employ instead a meaning which will give effect to the statutory purpose." (R. 47; Emphasis added.)

This petitioner had argued in the Tax Court that the portion of its sales price which merely reimbursed it for taxes which it had to pay upon the sale of each unit of its product was not "amounts received" from "the sale . . . of stock in trade of the taxpayer. . . ." The above quotation from the Tax Court's opinion in effect attempts to answer this contention by saying that Congress said total amounts received and that the use of this phrase makes unnecessary an examination of what the amounts were received for.

That Congress was concerned that a taxpayer's growth be measured in reference to its physical volume of production is echoed in its choice of the phrases "stock in trade," "property properly includible in inventory," and "property held primarily for sale to its customers." For the Tax Court to say that the use of the phrase "total amount received" concludes any inquiry into whether a receipt should be attributable to the sale of a tangible unit of taxpayer's production is in effect to say that Congress meant to substitute for subsection (A) of Section 435(e)(5) a statute which would define gross receipts as "the total amounts received by the taxpayer."

The Tax Court's holding that the term "total amount received" includes "everything received by the corporation" makes it rather hard, if not impossible, to determine what Congress had in mind in subsection (B) of Section 435(e)(5), where it said that in addition to the amounts received by the taxpayer for its stock in trade "gross receipts" should include gross income attributable to a trade or business regularly carried on by the taxpayer and specifying certain exclusions from the latter.

The Tax Court's misconstruction of subsection (A) also fails to recognize that the itemized exclusions from subsection (B) were placed in the statute for a purpose. Should subsection (A) include "everything received by the corporation," as the Tax Court would have us believe, there would not only be no amounts includible in "gross receipts" under subsection (B) but there would be nothing upon which these exclusions might work.

The Tax Court reached its conclusion despite the well recognized maxim of statutory construction that no part of a statute can be presumed to be superfluous or redundant when any other interpretation is possible. The Supreme Court of the United States clearly expressed this canon of construction in the following words:

"Congress is not to be presumed to have used words for no purpose . . . the admitted rules of statutory construction declare that a legislature is presumed to have used no superfluous words. Courts are to accord a meaning, if possible, to every word of a statute." (*Platt v. Union and Pacific Railroad Company*, (1879) 9 Otto (99 U.S.) 48, 58.)

The petitioner's interpretation of Section 435(e)(5)(A) not only gives effect and meaning to every word of that subdivision, but also to the entire context of subdivision (B). The Tax Court's construction does not. Thus, we respectfully submit that because the Tax Court's construction makes redundant the language indicative of taxpayer's "physical volume of production" as well as Section 435(e)(5)(B) it cannot be sustained.

(C) The Tax Court Has Ignored the Legislative Intention That the Growth Formula Measure the Increase in Taxpayer's Physical Volume of Production.

The growth formula of the Excess Profits Tax Act of 1950 is one intended to measure the increase in the physical volume of production of the taxpayer; it is not a measure to be haphazardly applied upon varying taxpayers merely because somebody elected to impose, reduce, increase or repeal an excise tax, or a test dependent upon the varying effect of the varying state statutes imposing such taxes.

That Congress intended it to have such a constant and uniform effect is demonstrated by the statutory mandate that amounts be received from the sale of physical items of production (Section 435(e)(5)(A)) and by the Senate and House Committee reports justifying the growth formula because "a corporation may increase its physical volume of production materially" (*supra* p. 18). To include beer excise taxes reimbursed the petitioner upon the sale or distribution of its beer for consumption in "gross receipts" is to ignore this Congressional intent.

The Tax Court has made the following unwarranted assumption in its reference to the admitted test of the taxpayer's increase in physical volume of production:

"By that test items which remain stable in their relationship to units produced, such as taxes in the present case, do not throw the formula off nor make its working inequitable." (R. 47.)

Such a statement is a circumlocution which denies without disproving or even examining something which cannot be disputed. If the inclusion of the taxes in petitioner's

“gross receipts” accurately measured its physical volume of production, there would be no lawsuit here. The result would be the same whether they were included or excluded. The very fact that the result is not the same should end all discussion of the question whether or not the inclusion of such taxes properly measures a taxpayer’s physical volume of production.

The sales invoices and pricing schedules of petitioner (Exhibits III and IV to Stipulation of Facts; not printed pursuant to stipulation of parties) demonstrate that its sales prices were dependent upon and determined by the taxes applicable in the particular sales area. To include reimbursements for these taxes in petitioner’s “gross receipts” is to measure its growth by amounts which the petitioner is forced to advance by federal and varying state statutes, by sums which do not measure its physical volume of production, and by taxes which the consumer pays upon the purchase of petitioner’s product.

II. WHEN THE TAX STATUTE IS CONSTRUED IN THE LIGHT OF ITS PURPOSE AND INTENDED EFFECT, THE TAX COURT’S CONSTRUCTION OF IT CAN BE SEEN TO BE ERRONEOUS.

If the language of the statute leaves any doubt that petitioner is entitled to be classified as a growth corporation, we believe that consideration of the problem in the light of the purpose and intended effect of the statute will remove any such doubt.

As we have seen, the tax involved was designed to reach “increased profits due to the outbreak of hostilities

and to large military expenditures,"⁴ and the decision below results in this war profits tax reaching about \$1,000,000 of profits attributable to petitioner's growth attained before 1950 and not to war conditions at all. Why should it be supposed Congress intended this result?

Petitioner maintains that any approach to the problem will demonstrate that Congress could not have intended to deny petitioner the benefit of its growth. In selecting "gross receipts" as the measure of petitioner's growth, Congress did not intend to include reimbursements of beer excise taxes in those gross receipts.

1. The gross receipts test of growth was designed to grant relief to a corporation which had grown "substantially more rapidly than the average" in "its physical volume of production."⁵ Obviously a taxpayer which had not made any change in its product in the base period could conveniently measure its volume of production in units of that production, such as gallons of beer, but a taxpayer which had made changes in its product, such as from passenger automobiles to industrial trucks, or from typewriters to electronic tabulating machines, could

⁴H.Rep. No. 3142, 81st Cong., 2d Sess., p. 3; 1951-1 Cum. Bul. 188; Appendix B, *infra*.

⁵S.Rep. No. 2679 and H.Rep. 3142, 81st Cong., 2d Sess., 1951-1 Cum. Bul. at 203 and 258. See Appendix B, *infra*, for the entire relevant text. The complete quotation is:

"The use of the alternative gross receipts test is justified by the fact that a corporation may increase its physical volume of production materially by introducing additional equipment and new operating procedures which do not involve a corresponding increase in its labor force. The percentages used in the payroll and gross receipts tests are sufficiently large so that only those taxpayers will be able to qualify for the alternative credit whose business has grown substantially more rapidly than the average during the base period years."

not. Undoubtedly the use of "gross receipts" as a measure was because Congress sought one of universal application, without variables due to differences between industries and locations, or within single industries.

The Tax Court has said that its interpretation is consistent with Congress' evident purpose to use a constant measure, not varying between industries (R. 44-47). It has evidently conceived that because the taxes herein were stable in terms of units produced instead of variable according to selling price, its interpretation attains the desired uniformity between industries (R. 47). Yet we can quite readily demonstrate that that interpretation has quite the opposite effect. If the rate is constant, the fact is that only in cases of a flat unit tax is there any variation whether the tax is included in receipts or not. The interpretation adopted below can result in a member of one industry qualifying for relief and a member of another industry failing to do so, simply because of differences in the type of excise taxes to which they were subject.

Both federal and state beer excise taxes were unchanged in rate during the base period, and were in terms of units of production, not percentages of selling price (R. 46). The federal tax was \$8.00 a gallon, and the California state tax 62 cents a gallon.⁶ Thus, if a brewery raised its prices, the tax would not increase. As the brewery's prices increased, the ratio of fixed tax to increasing price would decrease. But if an industry subject to a different type of excise tax, one which was

⁶Petitioner paid no out-of-state beer taxes which, to the extent applicable, were paid by its distributors.

a fixed percentage of the price, should increase its price, the tax would increase with the price and hence the ratio of tax to price would remain constant. If the excise tax is part of the measure of growth, the effect of this is to require the first industry to grow more than the second one in order to be judged the same by this particular measure.

The base period was notoriously a period of price increases. The official United States Consumer Price Index⁷ shows the following price increases in consumer goods expressed in terms of an index of 100:

		Price Level
January 1946	-	77.8
January 1947	-	91.9
January 1948	-	101.3
January 1949	-	102.7
December 1949	-	101.0

This index increase of 23.2 points from January, 1946, to December, 1949, represents a percentage increase in price level of 30%. Compared to this overall price increase is petitioner's increase in base price of 21.6 per cent during the same period (R. 40), which establishes that petitioner's increase in gross sales and in net income was not attributable to excessive price increases. In fact, petitioner's price increases were below the average.

The significance of the effect of price increases is that Congress was thoroughly aware that prices generally had increased during the base period, and for this reason

⁷U.S. Department of Labor, Bureau of Statistics, Series A-1 (all items).

required the exceptionally high standard of growth of 150 to 100, when measured by gross receipts. In contrast, the standard of qualifying growth when measured by payroll was fixed at only 130 to 100.⁸ By way of additional contrast, the World War II excess profits tax, which provided for elimination of abnormal deductions or income, defined such abnormalities as those which exceeded the average of the four prior years by the ratio of 125 to 100.⁹ This ratio was adopted as a substitute for a "grossly disproportionate" test, which was considered to lack certainty.¹⁰ In framing the Korean excess profits tax, Congress reduced the ratio for qualifying abnormalities from 125 to 100 to 115 to 100 in the case of abnormal deductions¹¹ and to 110 to 100 in the case of abnormalities in income¹² Also, in providing relief for corporations which had made substantial changes in products or services dur-

⁸The average weekly earnings of production workers and non-supervisory employees (which would comprise most of the payroll of manufacturers) increased 20.4 per cent in the same period, from \$43.74 a week to \$54.92 in 1949 (Handbook of Labor Statistics, U.S. Department of Labor, Bureau of Statistics, Bulletin No. 916 (1947 Ed.); Hours and Earnings, Annual Supplement, Industry Report, U.S. Department of Labor, Bureau of Labor Statistics (April, 1953) p. 25).

Thus during the base period labor costs increased 20%, petitioner's prices increased 21.6%, and average consumer prices of all goods increased 30%. The comparison between the 20% increase in labor costs and the 30% increase in overall price levels is similar to the comparison between the 130 to 100 payroll increase and the 150 to 100 gross receipts increase required for qualification as a growth corporation.

⁹Sec. 711(b)(1)(G), (H) and (I), I.R.C. of 1939, as in effect from 1941 to 1945, inc.

¹⁰H.Rep. No. 146, 77th Cong., 1st Sess., p. 5; 1941-1 Cum. Bul. 552.

¹¹Sec. 433(b)(9).

¹²Sec. 442(d).

ing the base period, Congress retained the 125 to 100 ratio of the World War II law.¹³

But when it came to providing relief for growth corporations in the 1950 statute, Congress provided higher ratios than before as conditions for qualification. In an effort to provide appropriate tests for eliminating corporations the growth of which was not “substantially in excess of the growth of industry in general,”¹⁴ Congress provided, not the 125 to 100 test of World War II and of Section 443(a), but the higher ratio of 150 to 100 in the case of the gross receipts measure. Obviously, as we observed before, Congress knew what everyone else knew, that both wages and prices had risen during the base period. Undoubtedly these higher ratios were designed to compensate for that fact. Congress undoubtedly knew that prices had risen more rapidly than wages¹⁵ and for that reason required a greater increase in gross receipts than in wages¹⁶ to demonstrate growth “substantially in excess of” average.¹⁷

Since Congress evidently drafted this legislation so as to operate properly in the light of the fact of wage and price increases during the base period, it is inconceivable that Congress would have deliberately used a definition of

¹³Sec. 443(a)(3).

¹⁴H.Rep. No. 3142, 81st Cong., 2d Sess.; 1951-1 Cum. Bul. 203 (Appendix B, *infra*).

¹⁵See footnote 8, *supra*, for the actual percentages of increase.

¹⁶150 to 100 in gross receipts, 130 to 100 in wages, a difference of 20%.

¹⁷Petitioner's prices increased 21.6% during the base period (R. 40).

“gross receipts”, the key to one of the standards of qualification, which would operate differently, given the fact of price increases, dependent on the type of excise tax various taxpayers had to pay. It is an established rule that statutes are to be construed to operate uniformly if possible (*Knowlton v. Moore*, (1900) 178 U. S. 41, *R.F.C. v. Beaver County*, (1946) 328 U.S. 204) and uniformity between income taxpayers will not be achieved by requiring more growth of taxpayers subject to an excise tax expressed in terms of a fixed tax per unit of volume, in order to qualify for relief, than of taxpayers subject to an excise tax expressed as a percentage of selling price.

Yet if excise taxes on beer paid by petitioner to the federal and state governments and thereafter recovered from its customers or from the government are includible in petitioner’s “gross receipts”, this discrimination against petitioner and others in its class will result, producing an unintended lack of uniformity in the operation of the statute.

2. If reimbursements of consumer’s taxes, of which beer excise taxes are an example, are included in gross receipts, the measure of growth Congress used will discriminate between industries, and between taxpayers in differing geographical locations, because of differing results dependent on whether excise taxes were imposed on them or were increased during the base period. This result Congress could not have intended, for it is contrary to the established purpose to obtain uniform application of federal statutes. *R.F.C. v. Beaver County*, (1946) 328 U.S. 204.

Some industries are not subject to federal excise taxes, whereas others are. Some are subject to state excise taxes in some states but not in others. Some taxpayers within taxed industries sell largely in export and thus escape federal and state excise taxes to that extent, whereas others have comparatively few export sales and hence collect and pay over more excise taxes per unit of production than other members of the same industry. Some excise taxes, notably state and local, were increased during the base period, whereas others were not.¹⁸

A few simple tables will demonstrate the effect these differences can have, if excise tax collections are included in gross receipts. In each of these tables it is assumed that 100 units are originally sold at \$15.00 a unit without tax and that the tax when imposed is \$8.50 upon each unit.

I

Table I postulates increases in price, and compares a corporation subject to a fixed excise tax per unit with a corporation not subject to any excise tax. It shows that as the price increases the number of units the corporation subject to the tax must sell increases, in relation to the untaxed corporation, in order to obtain an increase in gross receipts to 150%, if the excise taxes are included in

¹⁸The beer excise taxes to which petitioner was subject were not increased during the base period (R. 46). However, as its growth increased so did its sales in other states, on which it paid no state excise taxes. In actuality, then, its ratio of excise tax collections to sales declined during the base period, thus slowing its growth as measured by the Tax Court.

gross receipts. This bears on the prior discussion as well as that herein.

Increase In Price	Number of Units that must be sold to Equal 150% Increase in Gross Receipts	
	No tax	Tax
0%	150	150
10%	136	141
20%	125	133
30%	115	126
40%	107	119
50%	100	114

II

Table II shows that, conversely, when the price decreases the corporation subject to the fixed excise must grow less than the untaxed corporation, in order to have a growth to 150% when measured in terms of gross receipts which include excise tax collections.

Decrease In Price	Number of Units that must be sold to Equal 150% Increase in Gross Receipts	
	No tax	Tax
0%	150	150
10%	167	160
20%	187½	172
30%	214	185
40%	250	200
50%	300	220

III

Table III compares the case of a taxpayer never subject to excise tax with a taxpayer originally subject to such tax but where the tax is eliminated at the end of the first two years of the base period, first assuming no increase in price in the second half of the base period and then assuming various percentages of increase in price up to 50%. It will be noted what a tremendous discrimination

exists in favor of the taxpayer never subject to tax with respect to the number of additional units which must be sold in order to produce an increase of 150% in gross receipts. Thus, where there is no increase in price, the untaxed taxpayer must sell only 150 units to qualify, whereas the taxpayer originally taxed must sell 235 units. At the other extreme of a 50% increase in price, the untaxed taxpayer must sell only the same number of units, i.e., 100, in the second half as in the first in order to increase its gross receipts by 150%, whereas the taxpayer originally subject to tax must sell 156 units.

Increase In Price	Number of Units that must be sold to Equal 150% Increase in Gross Receipts	
	Never any tax	Originally tax, but Eliminated
0%	150	235
10%	136	214
20%	125	196
30%	115	181
40%	107	168
50%	100	156

IV

Table IV deals with the converse situation, in which the first taxpayer is never subject to excise tax and the second taxpayer was not subject to tax in the first half of the base period but the tax is imposed at the beginning of the second half. Here it will be noted that, with no increase in price, the second taxpayer need sell only 96 units to increase its gross receipts by 150%, whereas the first taxpayer must sell 150 units. At the other extreme, with a 50% increase in prices assumed, the first (untaxed) taxpayer need sell only 100 units, but the second taxpayer will qualify by selling a mere 72½ units as against the 100 units it sold in the first half of the base period.

Increase In Price	Number of Units that must be sold to Equal 150% Increase in Gross Receipts	
	Never any tax	No tax to begin with, but added later
0%	150	96
10%	136	90
20%	125	85
30%	115	80½
40%	107	76
50%	100	72½

Table IV does not assume a hypothetical situation. In California, the state excise tax on distributors of gasoline was increased from 3 cents to 4½ cents a gallon effective July 1, 1947. That increase is exactly 50%. Moreover, in California, cities began to impose retail sales taxes for the first time during the base period. San Francisco's tax first became effective on October 1, 1947. The effective dates of those taxes for other major cities were: Beverly Hills, November 1, 1948; Berkeley, October 1, 1946; Burbank, April 1, 1948; Chico, January 1, 1949; Los Angeles, May 11, 1946; Napa, July 1, 1948; Oakland, October 1, 1946; Pasadena, April 1, 1948; Riverside, July 3, 1948; San Diego, July 1, 1946; San Jose, April 1, 1948; Santa Barbara, July 1, 1947; Santa Cruz, January 1, 1949; Stockton, April 1, 1948; Vallejo, September 2, 1947. These city taxes range from ½ of 1% to 1%, and are carbon copies of the state tax. Obviously, to include them or the gasoline tax in gross receipts would be enough to qualify some taxpayers for relief, merely because of the accident of tax increases.

V

Table V illustrates the geographical disparity in application of the statute produced by the Tax Court's posi-

tion. The beer excise tax in California is 62¢ per barrel, whereas in a number of other states it is more, the highest being the \$13.23 per barrel tax in Mississippi.¹⁹ If, as the Tax Court held, beer excise tax reimbursements are includible in gross receipts, the Mississippi brewer must grow more than the California brewer in order to qualify for relief, as shown in the following table.

Increase In Price	Number of Units that must be sold to Equal 150% Increase in Gross Receipts	
	California brewer (Fed. & Cal. Tax)	Mississippi brewer (Fed. & Miss. Tax)
0%	150	150
10%	141	144
20%	133	138
30%	126	133
40%	119	129
50%	114	124

The lack of geographical uniformity shown by Tables IV and V is not the only disparity the construction below produces. Let us return to Table IV and the schedule of city sales tax adoptions, considered above (p. 37). Petitioner is not a retailer and hence was not subject to these increased sales taxes, but retail vendors of its product were. Can it be supposed that Congress meant to define "gross receipts" so that a retailer of beer would qualify as a growth corporation and a manufacturer of beer with the same percentage of increase in unit sales would not, simply because of the fact that one acted as collector of the sales tax and the other did not? Yet the construction below, which would include in gross receipts sales taxes adopted in the latter half of the base period,

¹⁹Calif. Rev. & Tax. Code, Sec. 32151(a); Miss. Code Ann., Sec. 10242.

would have this effect. We submit that Congress intended no such senseless and purposeless discrimination.

Nor could Congress have intended to qualify gasoline distributors for relief but not brewers, merely because of the fact that state excise taxes on gasoline increased by 50% in the base period, whereas brewers' excise taxes were unchanged.

Yet discriminations of this sort, which Congress patently could not have intended, are implicit in the decision below. Only if consumer taxes imposed in the form of commodity excise taxes collected by the seller are excluded from the seller's "gross receipts", will the measure of growth have the uniform application geographically and between industries which Congress must have intended.

The Tax Court expressed doubt of its right to "give effect to the statutory purpose" in view of what it considered was the "simple and direct application" of the statutory language (R. 47). We believe we have demonstrated in the prior division of this brief that the "simple and direct application" of the language is the direct opposite of what the Tax Court held. But if it were not, the courts are required to construe a statute so as to attain its purpose (*Inland Waterways Corp. v. Young*, (1940) 309 U.S. 517; *Helvering v. Clifford*, (1940) 309 U.S. 311; *Helvering v. Stuart*, (1942) 317 U.S. 154; *United States v. Universal C.I.T. Corp.*, (1953) 344 U.S. 218). This is so even though a literal reading of the statutory language would suggest a contrary result, for it is well settled that the statutory purpose is to be attained even at the expense of literalness where literalness would lead

to absurd, unjust or other obviously unintended consequences (*Lionberger v. Rouse*, (1870) 9 Wall. (76 U.S.) 468; *United States v. Ryan*, (1931) 284 U.S. 167; *Sorrells v. United States*, (1933) 287 U.S. 435). Accordingly, even if, which we do not concede, the literal meaning of the statute supported the decision below, the unequal and absurd consequences of that application, defeating the purpose of the statute, would compel reversal.

3. The critical statutory phrase, "gross receipts", is not in general use in accounting or in income tax law.²⁰ The term commonly used in accounting usage and which appears in the income tax returns is "gross sales".²¹ There is no single generally accepted practice governing the inclusion or exclusion of excise taxes in or from "gross sales".²² Thus retail sales taxes are generally excluded from reports of gross sales in corporate reports and income tax returns. The same is true of gasoline excise taxes, and of federal taxes on phonographs, television sets and furs.²³ Their exclusion from "gross sales" means that one will study an income tax return in vain if he seeks to know how many dollars of such a tax a given taxpayer collected and paid over to the governments. Yet these taxes are collected by sellers, do pass through their hands and into their treasuries, and are reflected somewhere in their books of account, before being paid over to the imposing government.

²⁰R. 42, 94. It is not to be found in the Dictionary of Income Tax Terms (CCH, Inc., 1955).

²¹R. 42, 31, 33.

²²R. 40-41.

²³R. 40-41.

Beer excise taxes are handled accounting-wise in a variety of ways, but are customarily included in reported gross sales.²⁴ Some breweries place them in a special category to differentiate them from true costs of the goods sold,²⁵ although petitioner did not.²⁶

What this means in the administration of the excess profits tax on the theory adopted below is a real increase in the problems of audit and administration. The income tax return forms in use in the base period, in which the information necessary for determining qualification must have been supposed to have been present, simply would not contain that information, on the interpretation adopted below. Thus, the form called for the following information about gross receipts from sales:²⁷

1.	Gross sales (where inventories are an income-determining factor)	\$;	Less: Returns and allowances . . \$	\$
2.	Less: Cost of goods sold . (From Schedule A)
3.	Gross profit from sales			\$
4.	Gross receipts (where inventories are not an income-determining factor)		\$	
5.	Less: Cost of operations. (From Schedule B)	
6.	Gross profit where inventories are not an income-determining factor"

It will be seen that line 1 of the income tax return form denominated the amount received from the sale of inventory goods as "gross sales", line 2 called for "cost

²⁴R. 41; 83-84, 87-92.

²⁵R. 83.

²⁶R. 36.

²⁷Exh. I to Stipulation of Facts, R. 31-33.

of goods sold” which was deducted from “gross sales”, and line 3 called for the resulting balance, denominated “gross profit from sales”. The record herein, including the findings below, shows that in many industries and businesses a corporation’s collections of excise taxes will be omitted entirely from the “gross sales” figure,²⁸ and this means of course that it will not appear any place on the return. If, as the Tax Court held, excise taxes collected by a corporation at the time of sale are part of that corporation’s “gross receipts”, then the income tax returns of nearly every retailer corporation in the United States are inadequate to provide the information necessary for the determination of their excess profits credits. This is obviously a large class of taxpayers. To it must be added the corporations which pay gasoline excise taxes and collect them from the consumers, since the record shows²⁹ that they too customarily omit those tax collections from the figure shown as representing “gross sales”.

A decision that excise tax collections are not part of “gross receipts” gives less administrative difficulty. Corporations which include those collections in the figures shown for gross sales deduct them out either as a part of cost of goods sold,³⁰ as a separate deduction before arriving at gross profit or net sales (synonymous terms) or as a so-called “below-the-line deduction”,³¹ which means a deduction which is grouped with business expenses, salaries, interest and other general deductions. In any of these circumstances, the amount of the excise

²⁸R. 40-41.

²⁹R. 40.

³⁰As petitioner did (R. 36).

³¹R. 82.

tax collection will be set forth in schedules attached to the return so that where it has been included in gross sales it can be found, isolated and removed.

It is an accepted canon of construction that an interpretation which avoids administrative complications is to be preferred to one which creates them.³² As petitioner's interpretation does not require the tax law to be administered on the basis of figures not shown on the base period returns by a large class of taxpayers, petitioner's interpretation should be adopted.

4. Since the term "gross receipts" is a new phrase in income tax law, and since "gross sales", the term in use in income tax and accounting usage closest to it in meaning, has not a single settled usage or connotation concerning the omission or inclusion of excise taxes, the Congress did not employ a term of known, precise meaning, or a term which had acquired a precise artificial meaning in accounting or income tax usage. Perhaps Congress was well aware of this and for this reason sought to give precision to the term by defining it in Section 435 (e)(5). While we contend that the language of the definition is dispositive in our favor, our argument is now discussing the case on the premise that terms of the definition leave the matter in doubt.

A similar problem of statutory interpretation has been presented under laws taxing "gross receipts" from certain occupations and businesses, or from sales of selected commodities. Where the statute did not dispose of the

³²*NLRB v. Greensboro Coca Cola B. Co.*, (CA 4, 1950) 180 F. 2d 840, 845; *Haggar Co. v. Helvering*, (1940) 308 U.S. 337, 394; cf. *Universal Camera Corporation v. NLRB*, (1951) 340 U.S. 474, 489; *Knowlton v. Moore*, (1890) 178 U.S. 41.

problem by express provision, some courts have held that the "gross receipts" on which the tax was levied, or by which it was measured, did not include other excise taxes on the commodity. Thus, in *Standard Oil Company v. State Tax Commissioner*, (1941) 71 N.D. 146, 299 N.W. 447, where an excise tax on "gross receipts" from the sale of gasoline was involved, the federal gasoline excise tax imposed on the gasoline distributor and collected by him from the consumer was held not to be part of the seller's "gross receipts" since he was in actuality though not in form merely a collection agent for the federal tax. "Gross receipts" was defined by the statute as the total amount of sales by retailers, and hence sales price was held not to include excise tax reimbursements. And in *Socony Vacuum Oil Co. v. City of New York*, (1936) 247 App. Div. 163, 287 N.Y.S. 288, a city excise tax on "receipts" from sales at retail was involved. The state excise tax on gasoline imposed on the retailer and passed on by him to his customers was held not to be part of the retailer's taxable "receipts".

A case involving a definition closely similar to the one herein, and reaching the result for which we contend here, is *Standard Oil Company v. State*, (1937) 283 Mich. 85, 276 N.W. 908. That case involved a state sales tax on "gross proceeds" of sales. The term involved was thus not identical to the one herein but was similar. However, the term was defined in a way which is indistinguishable from the definition herein so far as the present problem is concerned. "Gross proceeds" was defined as "the amount received in money, credits, property or other money's worth in consideration of sales at retail . . ., with-

out deduction on account of cost of material, labor, or purchases, or amounts paid for interest or discount or any other expenses whatever.”³³ The question presented was whether the federal gasoline tax of one cent a gallon “imposed on gasoline sold by the producer” was includible in the producer’s “gross proceeds”. The Michigan Supreme Court held that the collections of federal gasoline tax should not be included in the taxpayer’s “gross proceeds” as defined.

Similar statutory language was similarly construed by the Alabama Supreme Court in *Ross Jewelers, Inc. v. State*, (1953) 260 Ala. 682, 72 So. 2d 402, where an earlier case from the same court (*Pure Oil Co. v. State*, (1943) 244 Ala. 258, 12 So. 2d 861) which had reached an apparently inconsistent conclusion was distinguished on the ground that it had involved a privilege tax measured by gross receipts. The definition of “gross proceeds” for sales tax purposes, which closely resembled the Michigan definition discussed in the preceding paragraph, was held not to include the federal excise tax on watches.

Finally, the Louisiana Supreme Court held that federal and state excise taxes on liquor should not be included in the taxable value of liquor stocks for state property tax purposes. The taxpayer was a retailer who had purchased liquor stocks from distillers, paying a price which included an element of reimbursement for the liquor excise taxes paid by the distiller. The statute provided that the retailer’s taxable cost should be:

³³For comparison, the language of the statute herein defines gross receipts to be “the total amount received or accrued . . . from the sale, exchange or other disposition of stock in trade of the taxpayer . . .”

“ . . . arrived at by computing the cost or purchase price of said shipment at the point of origin, plus the carrying charges to the point of destination . . . ”

Thus, unlike the statute herein, the Louisiana statute appeared literally to call for inclusion of the amount representing excise tax reimbursement in the defined subject. Nevertheless, in *F. Strauss & Son, Inc. v. Coverdale*, (1944) 205 La. 903, 18 So. 2d 496, the court held that the taxable cost to the retailer did not include the liquor excise tax reimbursement paid to the distiller. The court concluded that excise taxes were essentially consumers' taxes; hence the distiller and the retailer were both merely instruments of governmental policy in collecting the tax from the real taxpayer, the consumer. The court was influenced in arriving at its conclusion that the taxes were consumers' taxes by the fact that a floor stocks tax is imposed by Congress whenever the rates are increased, in order that liquor which was in the pipeline from distiller to consumer when the increase became effective would nevertheless bear the increased tax when the consumer bought it.

The circumstances which impressed the Supreme Courts of Louisiana, Michigan, North Dakota, Alabama and New York are present here. The beer excise taxes are consumers' taxes. This is so not only because sales and commodity taxes are generically consumers' taxes from the economic point of view,³⁴ but for more particularized

³⁴“ . . . any tax on sales or output tends to shift directly to the consumers of the products and is borne primarily in relation to consumer expenditures.” Due, *Government Finance, An Economic Analysis* (Irwin, 1954) p. 291.

reasons. When the federal beer excise tax involved herein was imposed on brewers in the 1939 Internal Revenue Code, a floor stocks tax was also imposed taxing beer held for sale by a retailer (Sec. 3191).³⁵

The state beer excise tax is that classic type of consumers' tax, a sales tax. It is imposed on "all beer . . . sold in this State by a manufacturer."³⁶ Beer consumed by employees,³⁷ beer spoiled, destroyed, exported or sold to another manufacturer³⁸ is exempt.

Accordingly, the reasoning of these state cases is applicable to this case.³⁹

When Congress was faced with the problem considered by these cases, it reacted just as these state courts did. The circumstances were these. The Revenue Act of 1918 imposed an excise tax on "soft drinks sold by the manufacturer . . . equivalent to ten per cent of the price for which so sold." The question arose whether the tax reimbursement the manufacturer received as part of the selling price was part of that selling price which was meant to be taxed. The Supreme Court held that it was.

³⁵Similarly, the federal manufacturers' excises had a floor stocks tax (Sec. 3400(b), 1939 I.R.C.) to reach goods which had already been sold by the manufacturer but had not yet reached the consumer.

³⁶Sec. 23, California Alcoholic Beverage Control Act as in effect in base period.

³⁷*Ibid.*, Sec. 23a.

³⁸*Ibid.*, Sec. 23b.

³⁹There are a smaller number of state cases to the contrary. *Pure Oil Co. v. State*, *supra*; *State Tax Commission v. Quebedeaux Chevrolet*, (1951) 71 Ariz. 280, 226 P. 2d 549; *Consol. Distributors v. Atlanta*, (1942) 193 Ga. 853, 20 S.E. 2d 421. The latest case on the subject refused to follow them and confined the earlier Alabama case (*Pure Oil Co. v. State*, *supra*) to its facts. *Ross Jewelers Inc. v. State*, (1954) 260 Ala. 682, 72 So. 2d 402.

Lash's Products Co. v. United States, (1929) 278 U.S. 175.⁴⁰ Congress soon overruled the court prospectively by enacting what was, during the period involved herein, Section 3441(a) of the 1939 Code.⁴¹ This section provides that for the purposes of those federal excise taxes which are a percentage of the sales price "there shall be excluded the amount of tax imposed by this chapter, whether or not stated as a separate charge."⁴² It should be noted that Congress took this action although the Supreme Court's interpretation in the *Lash Products* case did not, in the setting there presented, involve the serious discrimination and lack of uniformity of application between taxpayers which are the inevitable result of the Tax Court's decision in the instant case.

Accordingly, we know that when specifically faced with the problem, Congress agreed with those courts which have construed "gross receipts" and "gross proceeds" as not including reimbursements received for excise taxes passed on to the consumers.⁴³ This is, we believe, the most relevant indication of what Congress' disposition is concerning the problem presented here. Since it points in

⁴⁰As "price for which sold" is a broader term than that herein involved, the *Lash Products* case is not in point except as an historic fact.

⁴¹Originally enacted as Sec. 615 of the Revenue Act of 1932, and now in Sec. 4216(a), 1954 Internal Revenue Code.

⁴²As beer excise taxes are a fixed amount per unit of volume, not measured by price sold, they are not governed by this section.

⁴³If petitioner failed to pass these taxes on it would soon be insolvent. These taxes total about one-third of what the distributors of petitioner's beer pay to it. (R. 35-36.) The figures in the record show that out of each \$3.00 received from its distributors, petitioner paid beer excise taxes of \$1.00 and retained a profit for itself of 44¢. Obviously it could not absorb such a large tax in so much smaller a profit and survive.

the same direction as the considerations previously argued, it should be given effect.

5. If, as the Tax Court held, Congress did not mean to measure a taxpayer's growth by the receipts it received beneficially, from which it could expand and grow and by which it could buy materials to stay in business, then where did Congress intend to draw the line? Can it conceivably be, as the Tax Court said (R. 47), that all amounts physically received by a taxpayer from the sale of its stock in trade were intended to be included in its gross receipts?

The Tax Court's analysis seems to mean that collections by a taxpayer of the California use tax are to be included in the seller's gross receipts. This tax⁴⁴ is levied on the consumer, and the seller is not the consumer of the product which it sells. The tax operates exclusively on merchandise purchased from sellers that California cannot tax for constitutional reasons. Cf. *Chicago Bridge & Iron Co. v. Johnson*, (1942) 19 Cal. 2d 162, 119 P. 2d 945; *Southern Pacific Co. v. Gallagher*, (1939) 306 U.S. 167; *Felt & Tarrant Mfg. Co. v. Corbett*, (1939) 306 U.S. 62. The person liable for the tax is the consumer.⁴⁵ However, every retailer subject to California's territorial jurisdiction is required to collect the tax from the consumer as the agent of the state and pay it over.⁴⁶ The tax is a debt owed the state by the seller,⁴⁷ which, nonetheless, does

⁴⁴Calif. Rev. & Tax. Code Secs. 6201-6207, inc.

⁴⁵Rev. & Tax. Code Sec. 6202.

⁴⁶Id., Sec. 6203. *Brandtjen & Kluge v. Fincher*, (1941) 44 C.A. 2d Supp. 939, 111 P. 2d 979; *American Locker Co. v. City of Long Beach*, (1946) 75 C.A. 2d 280, 170 P. 2d 1005.

⁴⁷Id., Sec. 6204.

not shift the primary liability from the consumer to the retailer.⁴⁸ The retailer is, however, liable to the state for the amount it should have collected even if it fails to collect, with a 10% penalty.⁴⁹

The use tax is then something physically collected by the seller, but it is not his tax though he is liable to pay the state if he neglects to collect it from the consumer. The Tax Court has not said explicitly it would include this collection in the seller's gross receipts, but if the language it used in declaring the test it would apply is to be taken literally, it would have to. But to do so, to hold that a seller's growth is to be measured by the amounts it is compelled by law to collect as tax collector-agent for the state, is to reduce the growth test to an absurdity.

What of bottle deposits received by a seller, subject to an obligation to return them to the customer when he returns the bottles? These deposits are ordinarily not treated by retailers as income so long as they are liable to repay them.⁵⁰ They therefore do not appear in the income tax returns on the basis of which the growth credit presumably was intended to be checked. Yet they are physically received by the seller from the sales of his stock in trade. Are they therefore gross receipts? Surely not.

These questions, we submit, indicate that the Tax Court has been deluded by the simplicity of stating the test it would apply into believing that it would be as simple to

⁴⁸*Brandtjen & Kluge v. Fincher*, supra note 46.

⁴⁹Sec. 6591.

⁵⁰*Wichita Coca Cola Bottling Co. v. United States*, (CA 5, 1945) 152 F. 2d 6, cert. den. 327 U.S. 806.

apply as it was to state. As we have demonstrated, the test leads to improbable results when applied to two common situations. This means, of course, that Congress did not have that test in mind when it enacted the statutes.

To us it seems much more reasonable to conclude that what Congress meant by "gross receipts" was the taxpayer's beneficial gross receipts, reflecting its growth, and not including variables over which it had no control and from which it could derive no possible element of growth, such as consumers' taxes it was required to collect and pay over. This interpretation will give uniform application to the law both geographically and between industries, will lend ease and simplicity to administration, and will avoid absurd distinctions. Accordingly, the contrary interpretation below should be disapproved.

CONCLUSION.

The erroneous judgment of the Tax Court should be reversed.

Dated: February 27, 1957.

Respectfully submitted,

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(Appendices A and B Follow.)

Appendices A and B.

Appendix A

INTERNAL REVENUE CODE OF 1939

Sec. 435(e)(1):

(1) Taxpayers to which subsection applies.—A taxpayer shall be entitled to the benefits of this subsection if the taxpayer commenced business before the end of its base period, and if either—

(A) (i) the total assets of the taxpayer as of the first day of its base period (when added to the total assets for such day of all corporations with which the taxpayer has the privilege under section 141 of filing a consolidated return for its first taxable year under this subchapter), determined under paragraph (3), did not exceed \$20,000,000, and

(ii) the total payroll of the taxpayer (as determined under paragraph (4) for the last half of its base period is 130 per centum or more of its total payroll for the first half of its base period, or the gross receipts of the taxpayer (as determined under paragraph (5)) for the last half of its base period is 150 per centum or more of its gross receipts for the first half of its base period; * * * * *

Sec. 435(e)(2):

(2) Computation.—The average base period net income determined under this subsection shall be determined as follows:

(A) By computing (in the manner provided by the second sentence of subsection (4) (1)) the excess profits net income for each of the last 24 months in the base period.

(B) By computing the aggregate of the excess profits net income for each such month.

(C) By dividing by 2 the amount ascertained under subparagraph (B).

(D) By computing the aggregate of the excess profits net income for each of the last twelve months in the base period.

(E) By computing (in the manner provided by the second sentence of subsection (d) (1)) the excess profits net income for each of the twelve months in the period beginning July 1, 1949, and ending June 30, 1950. For the purposes of this subparagraph and subparagraph (G) the excess profits net income for any month after December 1949 shall be the "weighted excess profits net income" for the taxable year in which such month falls divided by the number of full calendar months in such year, but in no case shall such excess profits net income for any month be less than zero. The "weighted excess profits net income" for any taxable year beginning before July 1, 1950, shall be—

(i) 100 per centum of the excess profits net income for the taxable year if such year ends before July 1, 1950;

(ii) 90 per centum of the excess profits net income for the taxable year if such year ends after June 30, 1950, and before October 1, 1950;

(iii) 80 per centum of the excess profits net income for the taxable year if such year ends after September 30, 1950, and before April 1, 1951; and

(iv) 70 per centum of the excess profits net income for the taxable year if such year ends after March 31, 1951.

(F) By computing the aggregate of the excess profits net income for each of the twelve months referred to in subparagraph (E).

(G) In the case of a taxpayer who is entitled to the benefits of this subsection under paragraph (1) (B) and whose excess profits net income for the calendar year 1949 is not more than 25 per centum of its excess profits net income for the calendar year 1948, by computing—

(i) in the manner provided by subparagraph (E), the excess profits net income for each of the six months in the period beginning July 1, 1948, and ending December 31, 1948, and for each of the six months in the period beginning January 1, 1950, and [ending] June 30, 1950, and

(ii) the aggregate of the excess profits net income for each of the twelve months referred to in clause (i).

The average base period net income determined under this subsection shall be the amount ascertained under subparagraph (C), (D), or (F) whichever is the highest, except that in the case of a taxpayer described in subparagraph (G), its average base period net income determined under this subsection shall be the amount ascertained under subparagraph (C), (D), (F), or (G) (ii), whichever is the highest.

Sec. 435(e)(5):

(5) Gross Receipts.—As used in this subsection the term “gross receipts” with respect to any period means the sum of:

(A) The total amount received or accrued during such period from the sale, exchange, or other disposition of stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, and

(B) The gross income, attributable to a trade or business regularly carried on by the taxpayer, received or accrued during such period excluding therefrom—

(i) Gross income derived from the sale, exchange, or other disposition of property;

(ii) Gross income derived from discharge of indebtedness of the taxpayer;

(iii) Dividends on stocks of corporations; and

(iv) Income attributable to recovery of bad debts.

In the event that a taxable year falls partly within such period, there shall be allocated, for the purposes of subparagraphs (A) and (B), to the portion of the year within such period an amount of the total gross receipts (as defined in such subparagraphs) for such year in the same proportion as the number of months in such year within

the period bears to the total number of months in such year.

REGULATIONS 130

Sec. 40.435-2. Average base period net income—Alternative based on growth. Section 435(e) provides alternative methods of computing the average base period net income of certain taxpayers whose growth during the base period is shown by increased gross receipts or payroll during the last half of the base period. These alternative methods are also available in certain cases to a taxpayer meeting certain tests with respect to sales of products not generally available prior to 1946.

Sec. 40.435-3. Definitions. For the purpose of section 435(e)—(a) Total assets. The term “total assets” means an amount equal to the sum of cash and property other than cash, held by the taxpayer for purposes of the business. The total assets as of any day shall be determined as of the beginning of such day. The property is to be included in an amount equal to its adjusted basis for determining gain upon sale or exchange. See, in general, section 113 and the regulations prescribed thereunder. For special rule in the case of certain intangible property, see section 441(i). If the taxpayer is a member of an affiliated group of corporations which has the privilege under section 141 of filing a consolidated return for its first taxable year ending after June 30, 1950, there shall also be included the total assets of each member of such affiliated group whether or not a consolidated return is filed, and whether or not such corporation was a member of an affiliated group including the taxpayer on the day as of

which total assets are computed. Such total assets shall be determined in a manner consistent with the principles applicable with the respect to consolidated returns.

* * * * *

(c) Gross receipts. The term "gross receipts" with respect to any period means the sum of: (1) the total amount received or accrued during such period from the sale, exchange, or other disposition of stock in trade of the taxpayer, or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business, and (2) the gross income attributable to a trade or business regularly carried on by the taxpayer, received or accrued during such period, but excluding therefrom—

(i) gross income derived from the sale, exchange, or other disposition of property;

(ii) gross income derived from discharge of the taxpayer's indebtedness;

(iii) dividends on stocks of corporations; and

(iv) income attributable to recovery of bad debts.

(d) Net Sales. The term "net sales" with respect to any period means the total amount received or accrued during such period from the sale, exchange, or other disposition of stock in trade of the taxpayer, or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily

for sale to customers in the ordinary course of its trade or business; reduced by the amount of discounts, returns, and allowances paid or incurred for such period.

* * * * *

Sec. 40.435-4. Qualifications for computation of alternative average base period net income based on growth—

(a) In general. Section 435(e) is applicable only to a taxpayer which commenced business before the beginning of its base period and which establishes that it qualifies under either (b) or (c) of this section. A taxpayer computing its average base period net income by using an alternative based on growth shall submit with its return a full and complete statement showing the basis upon which each requirement of section 435(e) is satisfied and all the facts upon which the taxpayer relies.

(b) Eligibility requirements—General rule. A taxpayer which commenced business before the beginning of its base period shall be entitled to the benefits of section 435(e) if its total assets as of the beginning of the first day of its base period did not exceed \$20,000,000 and either—

(1) the taxpayer's total payroll for the last half (the last 24 months) of its base period is at least 30 percent greater than the taxpayer's total payroll for the first half (the first 24 months) of its base period, or

(2) the taxpayer's gross receipts for the last half (the last 24 months) of its base period are at least 50 percent greater than the taxpayer's gross receipts for the first half (the first 24 months) of its base period.

Where a taxable year falls partly within the first or second half of the base period, the amounts of the gross receipts or total payroll shall be allocated on a monthly basis to the appropriate period.

* * * * *

Sec. 40.435-5. Computation of average base period net income based on growth—(a) *Computation.* The following steps are required for the computation of average base period net income under the methods set forth in section 435(e):

(1) The excess profits net income for each of the last 24 months in the base period is determined as provided in the second sentence of section 435(d)(1).

(2) The amounts determined under (1) are aggregated.

(3) The aggregate amount ascertained under (2) is divided by 2.

(4) The excess profits net income for each of the last 12 months in the base period is aggregated.

(5) The excess profits net income (determined as provided in the second sentence of section 435(d)(1)) or the weighted excess profits net income (as defined in (b) of this section), as the case may be, for each of the 12 months in the period beginning July 1, 1949, and ending June 30, 1950, is computed.

(6) The amounts determined under (5) are aggregated.

(7) If a taxpayer meets the eligibility requirements with respect to products not generally available prior to 1946 (see section 40.435-4(c)), and does

not qualify under the general requirements for the alternative based on growth (see section 40.435-4(b)), and if its excess profits net income for the calendar year 1949 is not more than 25 percent of its excess profits net income for the calendar year 1948, then—

(i) The excess profits net income for each of the six months in the period beginning July 1, 1948, and ending December 31, 1948, and the weighted excess profits net income for each of the six months in the period beginning January 1, 1950, and ending June 30, 1950, are computed.

(ii) The amounts determined under (i) are aggregated.

(8) The average base period net income under section 435(e) is the amount ascertained under (3), (4), or (6) whichever is the highest. In the case of a taxpayer described in (7), the average base period net income is the amount ascertained under (3), (4), (6), or (7), whichever is the highest.

(b) Weighted excess profits net income. For the purpose of (a) (5) and (7) of this section, the term “weighted excess profits net income” applies to any month after December 1949, and means the weighted excess profits net income for the taxable year in which such month falls, divided by the number of full calendar months in such year. The term “weighted excess profits net income for the taxable year” applies only to taxable years beginning before July 1, 1950 (and ending after December 31, 1949), and is an amount equal to the following percentages of the excess profits net income for such taxable years:

(1) 100 percent of the excess profits net income for the taxable year if such year ends before July 1, 1950;

(2) 90 percent of the excess profits net income for the taxable year if such year ends after June 30, 1950, and before October 1, 1950;

(3) 80 percent of the excess profits net income for the taxable year if such year ends after September 30, 1950, and before April 1, 1951; and

(4) 70 percent of the excess profits net income for the taxable year if such year ends after March 31, 1951.

Appendix B

COMMITTEE REPORTS

I. Excerpt from H.Rep. No. 3142, 81st Cong., 2d Sess. (1951-1 Cum. Bul. 187, 203), and S.Rep. No. 2679, 81st Cong., 2d Sess. (1951-1 Cum. Bul. 240, 258) :

“The second test is designed to limit the benefits of the alternative credit to corporations experiencing a degree of growth during the base period which is substantially in excess of the growth of industry in general. For this purpose two indices are used, payrolls and gross receipts, and the taxpayer may qualify for the alternative basis under either one of them. If the taxpayer’s total payroll for the last half of the base period is 130 percent or more of its total payroll during the first half of the base period, it can qualify as a growing corporation. However, a taxpayer who fails to meet this test may qualify for the alternative credit if its gross receipts for the last half of the base period are 150 percent or more of its gross receipts for the first half of its base period. The use of the alternative gross receipts test is justified by the fact that a corporation may increase its physical volume of production materially by introducing additional equipment and new operating procedures which do not involve a corresponding increase in its labor force. The percentages used in the payroll and gross receipts tests are sufficiently large so that only those taxpayers will be able to qualify for the alternative credit whose business has grown substantially more rapidly than the average during the base period years.”

The Senate Report referred to contains a paragraph identical to the above except for the substitution of the following first sentence for that appearing above:

“In addition to meeting the assets test described above, a corporation desiring to use the alternative based on growth must qualify under a test designed to limit the benefits of the provision to corporations experiencing a degree of growth during the base period substantially in excess of the growth of industry in general.”

II. Excerpt from H.Rep. No. 3142, 81st Cong., 2d Sess. (1951-1 Cum. Bul. 187, 190), explaining the limitation of the credit to 85% of average base period earnings:

“4. *Average earnings credit.*

“For taxpayers on a calendar-year basis the base period under this bill is the 4-year interval 1946 to 1949. As a general rule taxpayers are permitted to eliminate one of the base-period years. The normal tax net income of the remaining years is then adjusted in a manner described below and averaged. The resulting average base period net income is then reduced by 15 percent for the purposes of the credit.

“Under the World War II law the base period was 1936 to 1939, and the credit was 95 percent of the average earnings in this period. It was necessary to substitute the period 1946 to 1949 for the 1936 to 1939 base in this bill both because of the large number of businesses which have been started recently and because of the substantial changes which have occurred in the businesses in existence between 1936 and 1939. The period 1946 to 1949 is the only recent 4-year, nonwar period available. However, it is a period of unusual business prosperity which to a substantial

degree was built on the deferred demands, the accumulated savings of World War II, and large post-war defense expenditures. Since this unprecedented level of business activity could hardly have been expected to continue permanently, the use of the income of the years 1946 through 1949, without adjustment, would produce a general overstatement of the taxpayers' earning capacity in the absence of hostilities in Korea or a large program of military expenditures. For this reason your committee believes that a 15 percent cut-back in average base period income is a moderate adjustment."

The Senate Finance Committee report (S.Rep. No. 2679, 81st Cong., 2d Sess., 1951-1 Cum. Bul. 240, 243) contains an almost verbatim duplicate of the foregoing explanation.

